



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PQA 720.7.102.5

January 31, 2001
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MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Revisions at CAM 10-408.2a, *Internal Control Audits*,
Addressing Audit Opinions when Significant System Deficiencies are Found

SUMMARY

CAM 10-408a(2) [now 10-408.2a] has been revised to require auditors to issue an *inadequate* or *inadequate in part* opinion when:

- significant deficiencies are found during an internal control audit, and
- the deficiencies have not been corrected as of the date of the audit report (even though the contractor has submitted a corrective action plan).

BACKGROUND

The quality assurance (QA) reviews of DCAA's internal audits performed in FY 2000, based on the *President's Council on Integrity & Efficiency (PCIE) External Review Guide*, found inconsistent interpretation and application of the Agency's guidance on determining the appropriate audit opinion when significant deficiencies were found. CAM 10-408a(2)(ii) allowed the auditor to issue an adequate opinion in "unusual circumstances" when significant deficiencies existed (e.g., a contractor had submitted a corrective action plan that, when implemented, would alleviate the deficiencies within a reasonable period of time). However, the QA reviewers found a number of cases that were not "unusual", and not in compliance with the intent of the CAM guidance or GAS reporting standards. The cases included auditors rendering *adequate* audit opinions even when:

- it was evident that the contractor would not be fully implementing its needed corrective actions within a reasonable period of time (usually within 60 days), or
- the deficiencies were previously reported and corrective action was promised at that time.

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GUIDANCE

As a result of the PCIE-based review findings, CAM 10-408a(2) [now 10-408.2a] has been revised. The audit opinion rendered on a contractor's system of internal control must now be either *inadequate* or *inadequate in part*, whenever both conditions below exist:

- The auditor finds one or more significant deficiencies in a contractor's system of internal control, *and*
- At least one of the deficiencies has *not* been corrected as of the date of report issuance.

When significant deficiencies are found and the contractor has proposed or is in the process of taking appropriate corrective actions, the actions should be described in the *Results of Audit* report section. The existence, however, of a corrective action plan will not make an inadequate system reliable. Therefore, the auditor should not report a contractor's system as "adequate" based on the contractor's corrective action plan. Before opining that the system is adequate, the auditor must first verify the contractor's implementation of the action plan correcting the deficiencies. A follow-up review should be performed as soon as possible to ensure the contractor's plan has been implemented.

The preceding revision to DCAA's audit guidance has been incorporated in the January 2001 edition of CAM. We have also enclosed the complete revision to CAM 10-408a(2) [now 10-408.2a] in line-in/line-out format, so that the reader can more easily see and compare the revised wording with the previous wording.

FAOs should direct questions to their regional office. Regional offices may direct inquiries to Mr. Kalle Lepiksaar, Program Manager, Quality Assurance Division, at (703) 767-2250, fax (703) 767-3258, or dcaa-pqa@dcaa.mil.

/s/ Robert DiMucci for

Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Enclosure:
Revision at CAM 10-408.2a

DISTRIBUTION: C

10-408.2 Internal Control Audits

~~(2)~~a. General. ~~For~~Evaluations of internal controls ~~s audits~~ express an overall opinion on the adequacy [i.e., adequate, inadequate in part or inadequate] of those aspects of the accounting and management system and related internal controls that were reviewed. For example, ~~the~~is Results of Audit paragraph may read:

“~~---~~In our opinion, the [indicate the system reviewed] system and related internal control policies and procedures of [Insert Contractor's Name] are adequate [or inadequate] [or inadequate in part].”

- If no deficiencies are found, the system should be reported as adequate.
- If deficiencies are found that the contractor has already corrected, the system should be reported as adequate after the changes have been verified.
- If conditions are found that do not materially affect the adequacy of the system, but the system would be enhanced if they were corrected, they should be reported as “Suggestions to Improve the System” (see ~~(b.c.)~~ below). These conditions should not be reported as deficiencies.
- If significant deficiencies are observed, the opinion on the system should be either “inadequate in part” or “inadequate,” ~~“unless, in the auditor’s opinion, the contractor’s corrective plan is adequate (see (ii) below).”~~

~~(ii)~~ (1) If deficiencies are found that affect only parts of the system, the audit opinion should state that the system is inadequate in part and identify the inadequate portions of the system.

~~(ii)~~ ~~Where significant deficiencies are found and the contractor has agreed to correct them, there may be unusual circumstances, which lead the auditor to determine that the system may be reported as adequate. “Unusual circumstances” may include: voluntary contractor identification of the internal control deficiencies; a contractor which is in the process of correcting the deficiencies; or a contractor which has developed an acceptable correction plan that will alleviate the deficiencies within a reasonable period of time, usually within 60 days.~~

~~(ii)~~ ~~The decision to report the system as adequate in these situations is based on auditor judgment. The deficiencies and the corrective action plan must be described in an appendix to the report.~~

~~(ii)~~ ~~If the corrective actions are anticipated to extend beyond a reasonable period of time, or if the deficiencies remain after the originally estimated time has expired, the system will be reported as inadequate or inadequate in part.~~

~~(ii)~~ (2) If the deficiencies are so significant that the entire system is unreliable, the audit opinion should state that the system is inadequate. ~~The existence of a corrective action plan will not make an inadequate system reliable.~~

(3) When significant deficiencies are found and the contractor has proposed or is in the process of taking appropriate corrective actions, the actions should be described in this report section. However, the existence of a corrective action plan will not make an inadequate system reliable. The auditor should not report a contractor’s system as “adequate” based on the contractor’s corrective action plan, i.e., the auditor must first verify the contractor’s implementation of the action plan correcting the deficiencies. ~~In every case, if corrective actions are being made, a~~ follow up review should be ~~scheduled~~performed as soon as possible to ensure the contractor’s plan has been implemented.